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**CITY OF ROSEVILLE
MEMORANDUM ON INTERNAL CONTROL
AND
REQUIRED COMMUNICATIONS**

**FOR THE YEAR ENDED
JUNE 30, 2008**

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**CITY OF ROSEVILLE
MEMORANDUM ON INTERNAL CONTROL
AND
REQUIRED COMMUNICATIONS**

For the Year Ended June 30, 2008

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MEMORANDUM ON INTERNAL CONTROL

November 7, 2008

To the City Council of
the City of Roseville
Roseville, California

In planning and performing our audit of the financial statements of the City of Roseville as of and for the year ended June 30, 2008, in accordance with auditing standards generally accepted in the United States of America, we considered the City's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the City's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the City's financial statements that is more than inconsequential will not be prevented or detected by the City's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the City's internal control.

Our consideration of internal control was for the limited purpose described in the first paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control that we consider to be material weaknesses, as defined above.

Included in the Schedule of Other Matters are recommendations not meeting the above definitions that we believe to be of potential benefit to the City.

The City's written responses included in this report have not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

This communication is intended solely for the information and use of management, City Council, others within the organization, and agencies and pass-through entities requiring compliance with generally accepted government auditing standards, and is not intended to be and should not be used by anyone other than these specified parties.

Maze & Associates

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CITY OF ROSEVILLE
MEMORANDUM ON INTERNAL CONTROL STRUCTURE

SCHEDULE OF OTHER MATTERS

2008-01 INFORMATION TECHNOLOGY BEST PRACTICES RECOMMENDATIONS

We conducted an Information Systems Review with our audit which encompassed the financial information system and the network environment that houses it. We expanded our work in previous years beyond simply looking at financial information systems as a result of greater risks of unauthorized access caused by overall industry growth of web-based commerce and internet based financial systems. Internal controls that are present in the overall network environment have become more important and relevant to understanding the internal controls over the financial system. We believe Information System controls must be continuously improved and enhanced to stay ahead of the ever increasing sophistication of hackers and criminals.

Currently, there are no Information Technology standards to which local governments are required to conform. Indeed there are a wide variety of informal guidelines and suggested controls from many different organizations which local governments can use to implement appropriate controls to ensure adequate security over information technology. Our Information Technology staff have reviewed these informal guidelines and concluded that the certification and accreditation framework developed by the National Institute of Standards and Technology (NIST) for the Federal Information Security Management Act (FISMA) are the most appropriate for local government. NIST and FISMA represent the minimum security requirements for federal government agencies information systems. We understand the U.S. Department of Justice recommends these for local governments. Our procedures included performing an external network scan based on NIST criteria and in determining that internal control provides for:

- Internet access defenses including hacker prevention, detection and deterrent systems
- Security of data from physical or network access
- Adequately protecting data from unauthorized internal access
- Reasonable measures to ensure continuation of service

While the results of our work did not indicate material weaknesses, we noted a few areas which could be improved to conform to NIST guidelines. A summary of these recommendations which we believe are "best practices" are as follows:

Payment Card Industry Compliance

The City processes credit cards using point-of-sale systems. Any organization that processes credit cards is required to comply with the Payment Card Industry Data Security Standard (PCI-DSS), even if the processing is outsourced. The standard was developed to minimize the risk of loss due to security breaches in processing credit card transactions. Merchants which conform to the Standard pay lower transaction fees and minimize their liabilities which may result from security breaches than those that do not comply. The Standard requires varying levels of controls depending on transaction levels. In general, merchants must:

1. Fill out a self-assessment questionnaire (SAQ).
2. Submit the SAQ to acquiring banks.
3. Perform quarterly external network scans and submit the results to acquiring banks.
4. Have a full independent PCI audit performed by a Qualified Security Assessor (QSA) and submit it to acquiring banks. (Required for level 1 merchants only).

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We believe the City qualifies as a Level 3 or 4 merchant due to activity levels of less than 1 million transactions and currently it need only complete and maintain the SAQ in-house. However, we understand SAQ submissions will become mandatory for Level 3 and 4 merchants in the near future. Staff has not completed the SAQ, but should do so and prepare for the submission requirement.

Audit/Event Logging

The City does not appear to have audit logs on the financial application server, such that any change, addition or deletion of user accounts within the application are tracked and monitored. The City should have audit/event logs of any addition, deletion or change in financial application user accounts and that log should be monitored by someone without the rights to effect such changes. In addition, any administrative access such as upgrades or application modifications by IT personnel, outside consultants or vendors should also be logged and reviewed.

General Information Systems Controls

We reviewed the compliance of the City's information systems with the National Institute of Standards and Technology (NIST) information security standards based on a moderate risk system. We noted a number of controls that did not appear to be in place. A separate report of those controls was provided to the City's IT and Finance personnel. We recommend the City choose an appropriate industry standard like NIST to help plan, organize and review information security. In lieu of this selection, we recommend the City continue with the controls that we found in place during our review and review and implement the list of controls that we have provided to management.

Management Response:

PCI-DSS Compliance – In 2008, the City's bank made changes to its merchant service processes and are in compliance with PCI-DSS. The City is in the process of reviewing all other credit card payment processes and working to make procedural changes per the requirements.

Audit/Event Logging – The financial system provides audit reports on any changes to users automatically. These reports will be kept and signed off by the IT's Systems Software Manager. In addition, upgrades or modifications will be tracked and reviewed.

General Information Systems Controls – IT personnel have reviewed the report of controls and was already in the process of implementing or had plans to implement four of the eight control areas noted by the auditors. IT personnel will review the remaining control areas to determine what steps, if any, should be taken to address the issues noted.

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2008-02 Upcoming GASB - Statement No. 49 - Accounting and Financial Reporting for Pollution Remediation Obligations (Effective for Fiscal Year 2008-2009)

This Statement addresses accounting and financial reporting for pollution remediation obligations (including contamination), which are obligations to address the current or potential detrimental effects of existing pollution by participating in pollution remediation activities such as site assessments and cleanups. This Statement excludes pollution prevention and landfill closure or post-closure costs. A municipality must estimate expected outlays for pollution remediation if it knows a site is polluted and any of the following recognition triggers occur:

- Pollution poses an imminent danger to the public or environment and a government has little or no discretion to avoid fixing the problem.
- A government has violated a pollution prevention-related permit or license.
- A regulator has identified (or evidence indicates it will identify) a government as responsible (or potentially responsible) for cleaning up pollution, or for paying all or some of the cost of the clean up.
- A government is named (or evidence indicates that it will be named) in a lawsuit to compel it to address the pollution.
- A government begins or legally obligates itself to begin cleanup or post-cleanup activities (limited to amounts the government is legally required to complete).

Liabilities and expenses would be estimated using an "expected cash flows" measurement technique, which is used by environmental professionals, but will be employed for the first time by governments. Statement 49 also will require governments to disclose information about their pollution obligations associated with clean up efforts in the notes to the financial statements.

Pollution remediation outlays should be capitalized in the government-wide statements, when goods and services are acquired, for any of the following circumstances:

- a. To prepare property for sale. Capitalized costs (including pollution remediation costs) continue to be limited to lower of cost or net realizable value
- b. To prepare property for use when the property was acquired with known or suspected pollution that was expected to be remediated. Governments should capitalize only those pollution remediation outlays expected to be necessary to place the asset into its intended location and condition for use.
- c. To perform pollution remediation that restores a pollution-caused decline in service utility that was recognized as an asset impairment. Governments should capitalize only those pollution remediation outlays expected to be necessary to place the asset into its intended location and condition for use.
- d. To acquire property, plant, and equipment that has a future alternative use. Outlays should be capitalized only to the extent of the estimated service utility that will exist after pollution remediation activities uses have ceased.

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For outlays under criteria a and b, capitalization is appropriate only if the outlays take place within a reasonable period prior to the expected sale or following acquisition of the property, respectively, or are delayed, but the delay is beyond the government's control.

Management Response:

The City will implement the provisions of the Statement in fiscal year 2009 for any applicable projects.

2008-03 Upcoming GASB Statement No. 51, Accounting and Financial Reporting for Intangible Assets (Effective for fiscal 09/10) - Retroactive Application Required

Governments have different types of intangible assets, such as easements, water rights, patents, trademarks, and computer software. Easements are referred to in the GASB 34 description of capital assets, which has raised questions about whether and when intangible assets should be considered capital assets for financial reporting purposes.

The absence of specific authoritative guidance has resulted in inconsistencies in the recognition, initial measurement, and amortization of intangible assets among governments. The objective of this Statement is to establish accounting and financial reporting requirements for intangible assets to reduce inconsistencies and enhance comparability.

A summary of the statement:

- Intangible assets should be classified, accounted for and reported as capital assets, unless excluded from the scope. Guidance in this statement is in addition to existing capital asset guidance.
- GASB 51 specifically addresses the nature of intangible assets.
 - *Lack of physical substance.* An asset may be contained in or on an item with physical substance, for example, a compact disc in the case of computer software. An asset also may be closely associated with another item that has physical substance, for example, the underlying land in the case of a right-of-way easement. These modes of containment and associated items should not be considered when determining whether or not an asset lacks physical substance.
 - *Nonfinancial nature.* In the context of this Statement, an asset with a nonfinancial nature is one that is not in a monetary form similar to cash and investment securities, and it represents neither a claim or right to assets in a monetary form similar to receivables, nor a prepayment for goods or services.
 - *Initial useful life greater than one year.*
- GASB 51 excludes:
 - Assets acquired or created primarily for the purpose of directly obtaining income or profit.
 - Assets resulting from capital lease transactions reported by lessees.
 - Goodwill created through the combination of a government and another entity.
- Recognition of an intangible asset occurs only if it is considered identifiable. That is when either of the following apply:
 - The asset is separable from the government. That is it can be sold, transferred, licensed, rented, or exchanged.
 - The asset arises from contractual or other legal rights, regardless of whether transferable or separable.

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- Specific conditions must present to recognize internally generated intangibles. Capitalization of costs begins after all of the following criteria are met:
 - Determination of specific objectives of the project and the nature of the service capacity expected upon the completion.
 - Demonstration of the feasibility that the completed project will provide its expected service capacity.
 - Demonstration of the current intention, ability, and effort to complete or continue development of the intangible asset.
 - Internally generated computer software is used as an example in applying the specific conditions approach.
- Amortization lives are addressed:
 - Limited by contractual or legal provisions.
 - Renewal periods for rights may be considered if there is evidence that the government will seek and be able to achieve renewal and that any anticipated outlays to be incurred as part of achieving the renewal are nominal. Such evidence should consider the required consent of a third party and the satisfaction of any conditions required to achieve renewal.
 - An indefinite life (no amortization) is permitted so long as there are:
 - No limiting legal, contractual, regulatory, technological, or other factors, and
 - No subsequent change in circumstances.
 - A permanent right-of-way easement is an example.

Retroactive Application. For GASB 34 Phase I & II governments, retroactive reporting is required for intangible assets acquired in fiscal years ending after June 30, 1980. Retroactive reporting is not required for intangible assets with indefinite useful lives or internally generated intangibles, as of the effective date of this Statement.

Management Response:

The City will develop procedures to address the new GASB.

2008-04 GASB Statement No. 53 Accounting and Financial Reporting for Derivative Instruments (Effective for fiscal 09/10)

This Statement is intended to improve how state and local governments report information about derivative instruments in their financial statements. Specifically, GASB 53 requires governments to measure most derivative instruments at fair value in their financial statements that are prepared using the economic resources measurement focus and the accrual basis of accounting (proprietary and entity-wide financial statements). Governments enter into derivative instruments as investments; as hedges of identified financial risks associated with assets or liabilities, or expected transactions (that is, hedgeable items); or to lower the costs of borrowings. Governments often enter into derivative instruments with the intention of effectively fixing cash flows or synthetically fixing prices. Common types of derivative instruments used by governments include interest rate and commodity swaps, interest rate locks, options (caps, floors, and collars), swaptions, forward contracts, and futures contracts. In addition, this standard addresses hedge accounting requirements.

Management Response:

The City will develop procedures to implement the new GASB in fiscal year 2010.

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CITY OF ROSEVILLE
REQUIRED COMMUNICATIONS

November 7, 2008

To the City Council of
the City of Roseville
Roseville, California

We have audited the financial statements of the City of Roseville as of and for the year ended June 30, 2008 and have issued our report thereon dated November 7, 2008. Professional standards require that we advise you of the following matters relating to our audit.

Financial Statement Audit Assurance: Our responsibility, as prescribed by professional standards, is to plan and perform our audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit in accordance with generally accepted auditing standards does not provide absolute assurance about, or guarantee the accuracy of, the financial statements. Because of the concept of reasonable assurance and because we did not perform a detailed examination of all transactions, there is an inherent risk that material errors, fraud, or illegal acts may exist and not be detected by us.

Other Information Included with the Audited Financial Statements: Pursuant to professional standards, our responsibility as auditors for other information in documents containing the City's audited financial statements does not extend beyond the financial information identified in the audit report, and we are not required to perform any procedures to corroborate such other information. Our responsibility also includes communicating to you any information that we believe is a material misstatement of fact. Nothing came to our attention that caused us to believe that such information, or its manner of presentation, is materially inconsistent with the information, or manner of its presentation, appearing in the financial statements. This other information and the extent of our procedures is explained in our audit report.

CITY OF ROSEVILLE
REQUIRED COMMUNICATIONS

Accounting Policies: Management has the responsibility to select and use appropriate accounting policies. A summary of the significant accounting policies adopted by the City is included in Note 1 to the financial statements. There have been no initial selections of accounting policies and no changes in significant accounting policies or their application during 2008. As described in notes to the financial statements, during the year, the City implemented the following new standards:

- GASB Statement No. 45 – Accounting and Financial Reporting by Employers for Postemployment Benefits other than Pensions.

This Statement established uniform financial reporting standards for employers providing postemployment benefits other than pensions (OPEB). There was no cumulative effect on prior year financial statements. However, Note 13 to the financial statements was modified to include required disclosures.

- GASB Statement No. 48 - Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues

This Statement establishes financial reporting of several categories of transactions. There was no cumulative effect on prior year financial statements. However, Note 9 to the financial statements was modified to include disclosures of revenue pledged for repayment of debt.

- GASB Statement No. 50 Pension Disclosures — an amendment of GASB Statements No. 25 and No. 27

This Statement amends disclosure requirement for defined benefit pension. The current disclosures of Note 12 to the financial statements comply with this Statement.

Unusual Transactions, Controversial or Emerging Areas: No matters have come to our attention that would require us, under professional standards, to inform you about (1) the methods used to account for significant unusual transactions and (2) the effect of significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus. There have been no initial selections of accounting policies and no changes in significant accounting policies or their application during 2008. While there have been no changes in accounting policies or disclosures resulting from the credit crisis, we believe the unprecedented volatility of credit markets occurring after year end warrants mention.

- *Credit Risk and the Financial Crisis:* The City has credit risks in its investments (Notes 3E). Credit risks as of June 30, 2008 for these areas have been disclosed in accordance with generally accepted accounting principals.

However, subsequent to year end, financial markets experienced significant reductions of available credit and certain financial institutions have had their credit ratings downgraded with one large institution entering bankruptcy. The federal government has taken steps to support financial markets in an effort to stave off further negative trends. These conditions have increased credit risks which warrant continuous monitoring and reassessment of the risk that credit counterparties and investees maybe downgraded or be unable to fulfill their obligations. Highest priority should be placed on maintaining a credit watch on its counterparties and formulate contingency plans as needed to ensure credit remains available for its operations.

**CITY OF ROSEVILLE
REQUIRED COMMUNICATIONS**

Estimates: Accounting estimates are an integral part of the financial statements prepared by management and are based on management's current judgments. Those judgments are normally based on knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ markedly from management's current judgments. The most sensitive accounting estimates affecting the financial statements are fair values of Investments.

- *Estimated Fair Value of Investments:* As of June 30, 2008, the City, held approximately \$720 million of cash and investments, as measured by fair value. Fair value is essentially market pricing in effect as of June 30, 2008. These fair values are not required to be adjusted for changes in general market conditions occurring subsequent to June 30, 2008.

Disagreements with Management: For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter that could be significant to the City's financial statements or the auditor's report. No such disagreements arose during the course of the audit.

Management informed us that, and to our knowledge, there were no consultations with other accountants regarding auditing and accounting matters.

Retention Issues: We did not discuss any major issues with management regarding the application of accounting principles and auditing standards that resulted in a condition to our retention as the City's auditors.

Difficulties: We encountered no serious difficulties in dealing with management relating to the performance of the audit.

Audit Adjustments: For purposes of this communication, professional standards define an audit adjustment, whether or not recorded by the City, as a proposed correction of the financial statements that, in our judgment, may not have been detected except through the audit procedures performed. These adjustments may include those proposed by us, but not recorded by the City, that could potentially cause future financial statements to be materially misstated, even though we have concluded that the adjustments are not material to the current financial statements.

We did not propose any audit adjustments that, in our judgment, could have a significant effect, either individually or in the aggregate, on the City's financial reporting process.

Uncorrected Misstatements: Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. We have no such misstatements to report to the audit committee.

This report is intended solely for the information and use of the City Council, its committees, and management and is not intended to be and should not be used by anyone other than these specified parties.

Mane & Associates

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